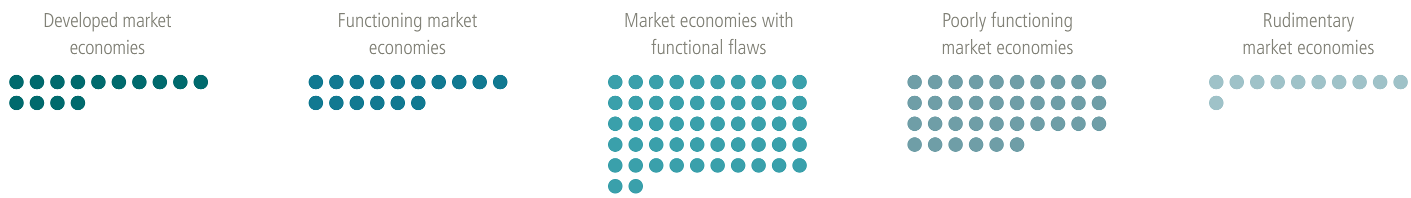
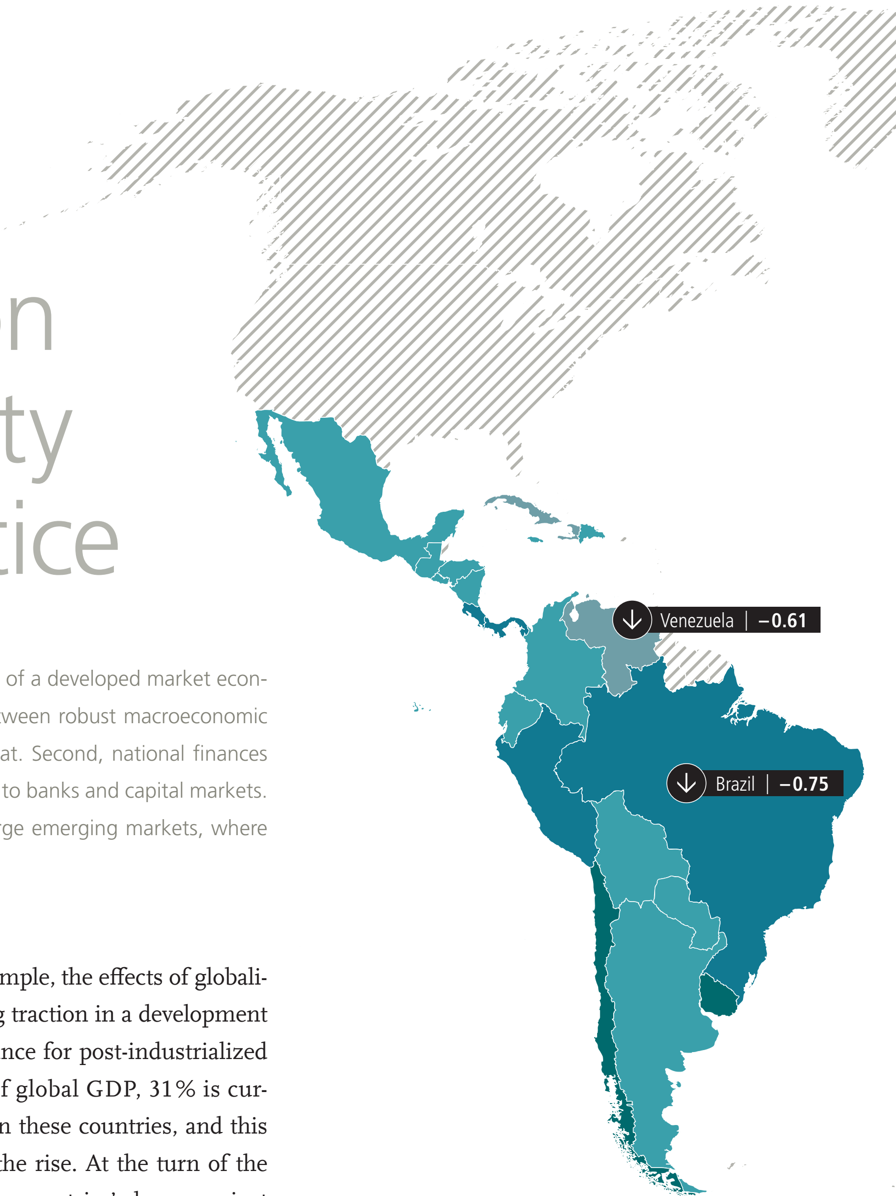


Economic transformation

Rising opposition against inequality and social injustice

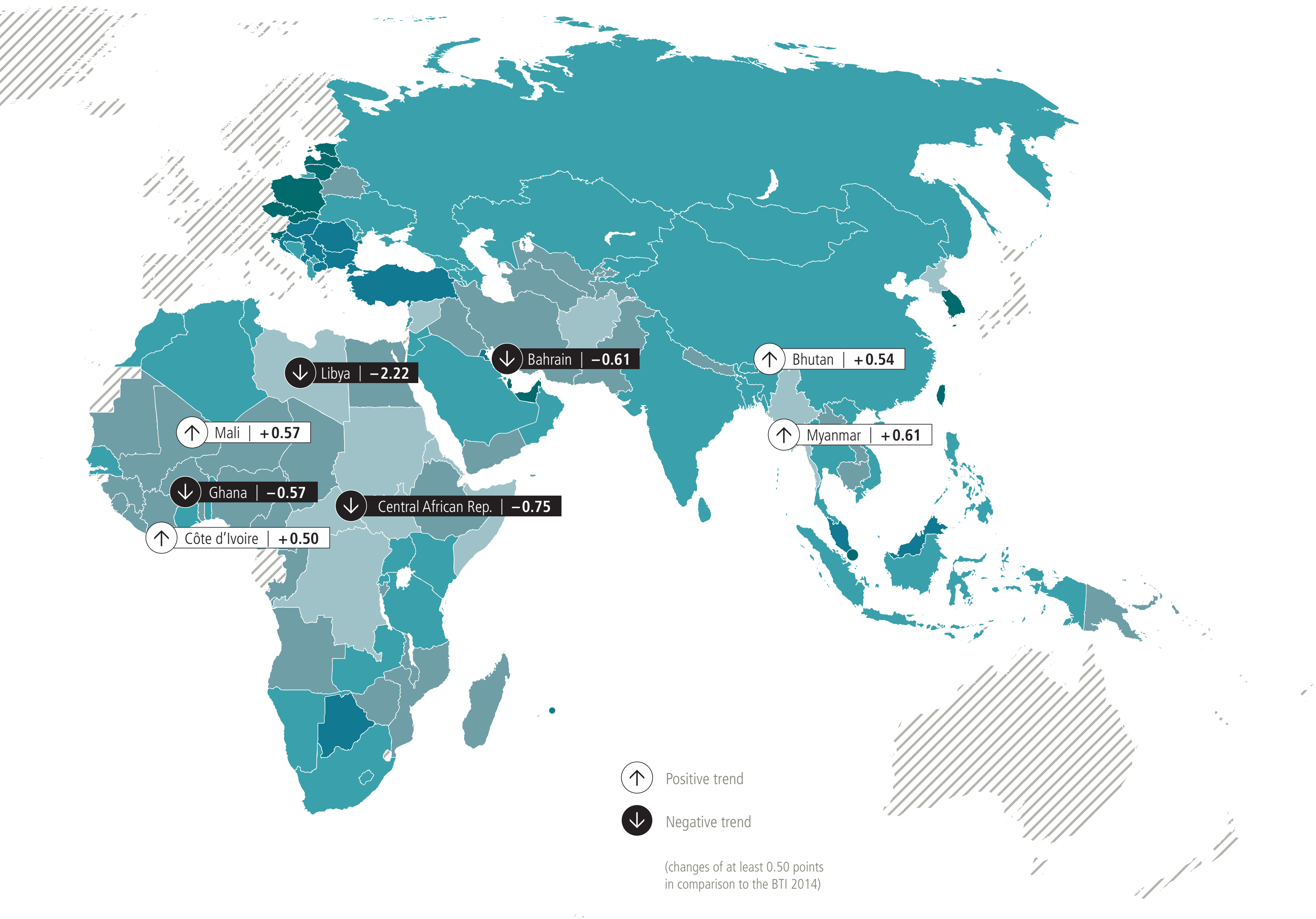


Only about 10 % of the countries surveyed correspond to the BTI profile of a developed market economy. Three discrepancies are particularly striking. First, the contrast between robust macroeconomic performance and low levels of social inclusion remains persistently great. Second, national finances have been destabilized, in some cases through state-provided assistance to banks and capital markets. Third, there is a growing gap between aspirations and reality in the large emerging markets, where economic output has recently flagged.

While ever more citizens in developing and emerging markets are demanding accountability from their governments' economic and social policies and calling for greater political and social inclusion, the international public is becoming increasingly conscious of the immense political and economic challenges facing the rising economies. Economic issues beyond the industrialized countries' borders are today no longer seen solely in a security- or development-policy context, but rather are regarded as having direct relevance to the globalized world economy.

The importance of emerging economies is shown by a look at the BTI 2016's two biggest groups of countries, in this case the market economies with functional flaws and the poorly functioning market economies. In these groups, which respectively include 52 and 36 countries, and thus two-thirds of the overall country sample, the effects of globalization are gaining traction in a development of growing relevance for post-industrialized countries, too. Of global GDP, 31 % is currently produced in these countries, and this figure is still on the rise. At the turn of the millennium, these countries' share was just 14 %. Three-quarters of the world's population lives in these economies, among which are the three most populous emerging markets: China (6.61 points), India (6.18 points) and Indonesia (6.04 points). If initially local transformation crises in this group of countries – whether in the form of economic slumps, failed economic policies or social conflicts – were to spread to other emerging markets, they would also reach the global level, with direct consequences for the economically networked world. In China's case, a moderate slowdown in growth has already sufficed to dim the global economic outlook.

Conversely, economic transformation strategies that have yielded successes in these not-yet-fully developed economies provide insight into promising economic-policy management. Bhutan is one such example. The experiment with a democratic state capitalism in the country that invented "gross national happiness" is showing its first successes. The state is placing a considerable bet on India's growing appetite for energy. Looking to the expected income from the export of hydroelectric power, the Himalayan nation is planning not only to refinance



the enormous public expenditures for the hydroelectric plants currently under construction, but also to continue to combat poverty effectively by integrating the rural population into the advances being made in education. The BTI country experts and international creditors agree in their assessment that the country's present national debt of more than 100% of annual economic output, which elsewhere would be flagged as a serious credit risk, is not a long-term obstacle to development. Nevertheless, Bhutan remains far from being a functioning market economy due to its relative socioeconomic underdevelopment, poor environment for market competition and significant obstacles to private enterprise.

Côte d'Ivoire, which is even farther from becoming a functioning market economy, also made significant gains during the review period. This is primarily due to the macroeconomic reforms implemented by Alassane Ouattara, who defended his presidency in violent clashes with the loser of the 2010 elections. The effects of these reforms can already be seen in the fact that the third-largest economy in West Africa, in recovery since the end of major political violence in 2011, improved its score in the BTI dimension of economic transformation by more than half a point for the second consecutive time. However, the country's market economy can only become fully functional if the economic and financial policymakers around Ouattara, the former central banker, offer new political, economic and social opportunities to the disproportionately young and extremely poor population. This could be achieved, for instance, through a land reform, by expanding the public health and education sectors, by rejuvenating the old political elite with younger members, and by professionalizing the national security forces in such a way as to take former militia members into account.

Mali, Côte d'Ivoire's northern neighbor, has also improved economic and social conditions for successful transformation. Since the June 2013 peace agreement between the government and the Tuareg, the country's poorly functioning market economy has regained a portion of its lost performance and macrostability. However, Mali is still more than half a point below the economic-transformation level it had reached in the BTI 2012. The repercussions of war in northern Mali continue to cause serious problems, including the displacement of 100,000 people, persistent food insecurity and employment loss impacting nearly one in three Malians.

Eleven countries without economic transformation

The most significant declines among the functionally flawed and poorly functioning economies were seen in Bahrain, Ghana and Venezuela, all of which have one thing in common: Their public finances have come under pressure as a result of falling commodity-export income, while currency devaluations have made imports more expensive and increased the overall price level. Bahrain's government bought citizens' loyalty through generous blanket subsidies while maintaining low tax rates, which is a financially shortsighted policy in a time of declining oil revenues. In Ghana, long-recognized structural weaknesses in an economy dependent on gold and cocoa income are becoming increasingly clear. Even after the currency reform of 2014, the value of the national currency remained in free fall. In combination with an undisciplined fiscal policy, the pressure on the Ghanaian cedi has helped feed a double-digit inflation rate. Revenues from the Jubilee oilfield discovered in 2007 and the recent near-billion-dollar loan from the IMF will afford short-term relief at best. In Venezuela, one of the world's biggest oil exporters, the government has continued its generous spending policy despite disastrous economic prospects and depleted reserves. The population is feeling this mismanagement in the form of inflation and a shortage of basic foodstuffs.

The largest deterioration with regard to economic transformation is evident in the failing states of Libya and the Central African Republic. In these countries, order has collapsed as a consequence of military conflicts between civil-war combatants, leaving only rudimentary market economies. The two states are thus among the small but growing group of countries in which no economic transformation is taking place due to war or a lack of political will. This group now contains 11 countries – an infelicitous record for the BTI.

Among these 11 rudimentary market economies, Myanmar is the only one to show significant gains. Since 2011, the military dictatorship has embarked on a cautious course of political and economic reform. The introduction of a freely floating exchange rate and steps toward a liberalization of foreign trade have spurred economic growth. In addition, President Thein Sein's government not only announced social reforms; in 2014, it also implemented a comprehensive social security law passed in 2012. Nevertheless, corruption, a poor infrastructure and a weak-performing education system present significant development obstacles. The other rudimentary market economies have remained more or less consistent in their economic weaknesses or, like Syria (–0.43 points), have fallen still further back.

Little has changed at the upper end of the economic-transformation scale, with one exception: Brazil shows a clear negative trend and is the only one of the 30 developed and functioning market economies to do so. The Brazilian success story has been fading for a number of years – in large part due to an increasingly expansive spending policy that was implemented in reaction to the financial and economic crisis (which initially endangered macroeconomic stability) but still failed to prevent the subsequent slump in growth. Despite the successes of the progressive social policies of the Cardoso, Lula and Rousseff governments, Brazil remains among the countries in which income and wealth are particularly unevenly distributed. Hundreds of thousands of people have taken to the streets in recent years to protest against inflation, corruption and an inefficient public administration.

Overall, most of the 30 advanced countries are found in post-communist Europe or Latin America, and the composition of this group has changed in only one case: Panama has taken Bahrain's place among the functioning market economies. The Central American country has not only stabilized its fiscal position; it is experiencing a downright construction boom thanks to large infrastructure projects, such as the expansion of the Panama Canal, which began in 2007.

Six winners, 11 losers

By taking not just the BTI 2016 review period but the past 10 years into view, a number of quite significant developments become evident – for individual countries, for country groups and sometimes even at the global level. For example, six countries have greatly improved their state of economic transformation by more than 1.00 point. Uruguay (8.57 points / rank 10 in the BTI 2016) has successfully jumped from the functioning to the developed market economy category, and today has one of the most effective social systems worldwide, with exemplary private-property protections. The United Arab Emirates (8.14 / rank 14), still classified as a market economy with functional flaws in the BTI 2006, today numbers for the first time among the developed market economies, thanks particularly to improvements related to the equality of opportunity, education policy and the foundations of market-based competition. Moldova (5.79 / rank 60) still demonstrates functional market-economic flaws, particularly with regard to the concentration and amalgamation of political and economic power. However, it has continuously improved, and its dependence on the recently weakening Russian economy has been at least somewhat reduced thanks to its free-trade agreement with the European Union.

Three other countries with significant improvements in the past 10 years, all of which are found in sub-Saharan Africa, remain poorly functioning market economies. In Côte d'Ivoire (4.68 / rank 88), Malawi (4.61 / rank 90) and Liberia (4.54 / rank 94), the trends are fragile despite the notable progress. These countries' socioeconomic-development levels and welfare regimes remain underdeveloped to such an extent that a considerably longer period of economic development, along with social policies involving the redistribution of resources and societal power, will be needed in order to remedy the structural shortcomings faced on the path to a socially responsible market economy. Liberia's example, in particular, illustrates just how long this path is and how time-consuming the process of overcoming these barriers is likely to be. While this county has shown by far the greatest development gains of all countries surveyed in the BTI – a total of +2.15 points relative to the BTI 2006 – the post-civil-war country was unable to prevent the failure of its chronically understaffed and poorly performing health sector during the Ebola crisis.

Standing in contrast to the six countries with significant improvements of 1.00 or more points are 11 countries that have deteriorated to the same degree in the past decade. Although Hungary (7.79 / rank 16) remains a functioning market economy, it was hit harder by the crisis than were other Eastern European states due to persistently high budget deficits, a high degree of vulnerability to the fluctuations of international financial markets, its dependence on foreign investment and the high share of its loans taken out in foreign currencies. Bahrain (6.43 / rank 39) is an economically advanced country, but its policymakers have done too little to combat growing social inequality and have intensified discrimination against the Shi'ite majority population, a primary reason for the protests in 2011. In Thailand (6.29 / rank 42), the economy has never fully recovered from the 1997 Asian crisis. In addition, partly because of the ongoing power struggle between the old elites and supporters of former Prime Minister Thaksin Shinawatra (2001 – 2006), the country's economy continues to perform significantly below its full potential. Hurdles to recovery in Ukraine (5.36 / rank 73) have become considerably higher following the 2008 financial and economic crisis, and under the influence of the military conflict with pro-Russian separatists. The South Asian states of Nepal (4.29 / rank 102) and Pakistan (4.11 / rank 103), both of which have been subject to recurrent periods of conflict, have for years lacked robust economic growth and effective strategies for combating mass poverty. Iran (3.00 / rank 117) lacks the basic foundations of a competitive market-based system.

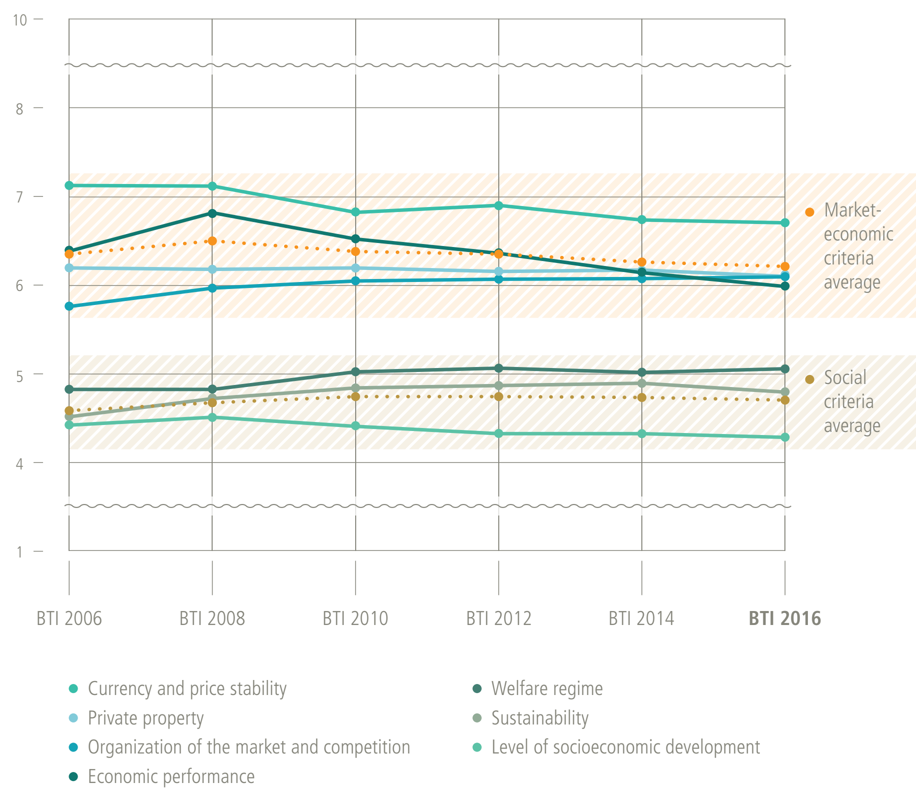
Syrian and Eritrean economies in a sorry state

For the time being, four countries in North Africa, the Horn of Africa and the Middle East lack any immediate prospect of economic transformation. Libya (2.89 / rank 119), Sudan (2.39 / rank 124), Syria (1.89 / rank 126) and Eritrea (1.36 / rank 128) not only feature rudimentary market economies, but are also among those six countries that have demonstrated the greatest declines since the BTI 2006. The humanitarian crisis in Syria and the political terror in Eritrea have driven large numbers of people into surrounding countries and even to Europe, with these states now numbering among the most significant countries of origin for the growing influx of refugees.

How does the economic balance sheet of the past decade thus appear as a whole? On the one hand, it is sobering. Even 10 years of mostly rapid growth in the emerging markets have not contributed to an overall increase with regard to the state of economic transformation. Only about 10 % of surveyed countries today display functioning market-economic systems as well as a high degree of socioeconomic development with functioning social systems.

On the other hand, the last decade's trends also inspire cause for optimism. A consideration of countries that show significant

Persistent gap between economic and social development



Global average scores include only the 118 countries that the BTI has surveyed consistently since 2006.

changes of 0.25 points or more reveals 45 countries with improvements as compared to 39 countries with declines. From this perspective, it is notable that the global economic crisis has not led to more extensive transformation setbacks in developing countries and emerging markets. This confirms the growing weight of the global South and clearly distinguishes the current era from earlier phases of world economic development, when crises in the capitalist centers had a direct impact on the periphery.

Social policies remain a major weak point

One gap documented persistently by the BTI since 2006 has remained clear and stable, specifically, that between the economic and social components of a socially responsible market economy. Evidently, governments worldwide are more successful in establishing growth-promoting market and competition frameworks, stable currencies and prices, and protections for private property than they are in overcoming socioeconomic barriers, providing social security and equality of opportunity, and formulating sustainable environmental and education policies. Once again, the BTI 2016 reveals economic criteria of currency and price stability (6.70), private property (6.14), organization of the market and competition (6.07) and economic performance (6.03) to be, on average, significantly above the social criteria of welfare regimes (5.05), sustainability (4.79) and the level of socioeconomic development (4.34).

Overcoming the imbalances between economic and social development is more than an altruistic goal. Socially inclusive outcomes, as measured by the BTI through indicators such as socioeconomic barriers and equal opportunity, actually do contribute to future economic growth and are thus directly economically relevant. Institutions possessing the political capacity to promote inclusive growth – the success of which are measured by the BTI through the social-safety-nets and education-policy indicators, among others – are critical for the success of whole societies over the long term. Social progress can only be achieved in the course of long-term processes that are generally nonlinear, and that are rarely free of conflict. Countries that have been equally successful in the economic and political spheres – such as Uruguay, whose welfare-state traditions stretch back to the early decades of the 20th century – show just how long the horizon for this type of development can be.

The "Washington Consensus" has failed to achieve its goals

The gap is largest in those places where the need is greatest, such as in the underdeveloped regions of sub-Saharan Africa, particularly West Africa. Benin, Burkina Faso, Mali and Niger are representative of a number of countries that have generated an above-average level of economic growth and are open to market-economic reforms even though this has not also led to broad-ranging improvements in living standards and opportunities for advancement within the general population. This assessment also applies to some Latin American and Asian-Oceanic countries, such as Guatemala, Honduras, Papua New Guinea and – at a somewhat higher level of development – India.

Social justice in emerging economies

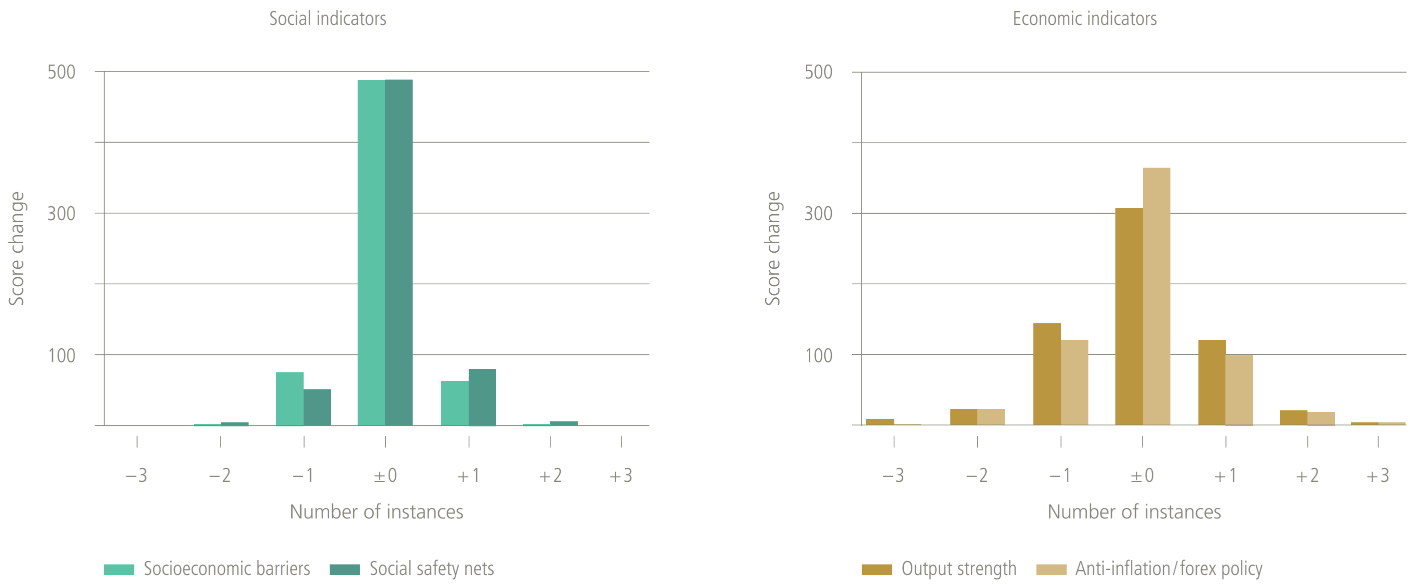
Transformation processes, by definition, involve major social challenges. In regions marked by widespread poverty, such as sub-Saharan Africa and South Asia, access to education and labor markets is also limited the most. In other emerging economies, many people face other difficulties: In China, where some 200 million labor migrants make a significant contribution to their country's economic growth, their often-precarious social position, the depopulation of rural areas and the tearing apart of families weigh heavily on current and future generations alike. In advanced emerging economies, such as Brazil, millions of people who have been lifted out of poverty but continue to face precarious conditions are calling on their government to protect them from sliding into poverty again.

For OECD and EU member states, the extent to which social-inclusion standards have been met is a well-researched subject, thanks in part to leading studies by the Bertelsmann Stiftung. However, the goal of a socially just society is not limited to rich developed countries. People outside of Europe and North America also want their societies to feature effective anti-poverty strategies; access to high-quality education, labor markets, health care; socially cohesive and non-discriminatory policies; and intergenerational justice. Sustained democratic and market-economic transformation hinges on improved governance in these areas. To date, there is no cross-national analysis of social inclusion in developing and transformation countries that combines each of these components into one conceptual measure.

Drawing on qualitative expert assessments, we will conduct an exploratory study of social inclusion in African, Asian and Latin American countries that is informed by established theories of social justice. Our objective is to identify, with the help of profiles on strengths and weaknesses, the gains made in and the major challenges to ensuring social inclusion, thereby providing policymakers with evidence-based best practices. The study combines current BTI data with available quantitative data from other sources.

The forthcoming working paper **"Social justice in emerging economies"** will be available at www.bti-project.org/workingpapers

Social indicators less volatile than economic indicators



Changes in BTI scores in four selected indicators over successive biennial surveys since 2006. The sample includes 628 data points.

In 90% of all surveyed countries, indicators associated with social participation trail those related to market-economic arrangements. The reasons for this are in significant part to be found in the one-sided pattern of prioritization that prevailed throughout recent decades. The fact that many national governments placed a higher priority on structural economic adjustments than on an active social policy must be seen against the background of the development-policy constellation of the late 20th century. Western donor countries and international financial institutions placed their focus on structural economic adjustment, increasing their emphasis on institutional and legal reforms in the 1990s with the declared goal of creating conditions appropriate for social progress and, particularly, for reducing poverty. According to this school of thought, the coexistence of market-economic regulatory policies and good economic performance, on the one hand, and relatively high socioeconomic-development barriers and social exclusion, on the other, should not necessarily be regarded as a shortcoming or contradiction. Rather, it was viewed as an intermediate stage, with economic and social development likely to follow one another in succession.

But the hoped-for trickle-down effect – a key aspect of a theory positing that liberalization, deregulation, privatization and low capital-gains tax rates would increase social disparities only temporarily as the accumulated wealth would lead in the medium term to more investment, increased production, more employment and ultimately higher incomes for the middle class – materialized to a far lesser degree than predicted. Significantly, at least since the beginning of the 2000s, state-capitalist developing countries following the Chinese model and countries with active social policies, such as Brazil, have been more successful in meeting the Millennium Development Goal of poverty reduction and in achieving economic growth than have those orienting themselves toward the so-called Washington Consensus.

The BTI, too, has been unable to confirm the trickle-down effect. The countries with the greatest "social justice gap" in the BTI 2006 – that is, the greatest difference between the BTI's economic and social criteria – have not advanced beyond a very low level of socioeconomic development throughout the last 10 years. This finding suggests that more must be done to strenghten the institutional underpinnings of social inclusion, and that it must be more resolutely targeted in the formulation of economic-development strategies.

Incidentally, the 13 countries that – contrary to the general trend – show higher scores in social than in economic criteria are likewise in most cases not to be recommended as models. The average economic-transformation status of these countries not only lies significantly below the BTI average (4.60 points as compared to 5.62 points), but has also declined by an average of 0.67 points in the last 10 years. Ten of these 13 countries, including Belarus, Cuba, Uzbekistan and Venezuela, rank among the lower half in terms of economic transformation. Although these countries usually feature good framework conditions for a potentially inclusive market-economic transformation in terms of human development, education and health care, their authoritarian governments oppose the introduction of far-reaching market-economic structures in favor of their own specific political-economy regimes.

Social inclusion possible in emerging markets, too

However, the BTI data from the six comparable editions since 2006 yields another explanation for the arrested state of social participation, this one on a global scale. The volatility of social indicators, such as socioeconomic barriers or social safety nets, is fundamentally lower than that of economic indicators, such as output strength or anti-inflation policy. Both positive and negative outcomes of social policies take longer to manifest themselves. This suggests that social-development progress requires significantly greater political efforts, and demands policies implemented over a longer term, than is the case for economic-performance variables and market-based competition and stability policies.

However, even taking this explanation into account, a perceptible if slow global tendency toward more social inclusion would indeed have been possible. Yet the BTI has identified few countries in which this justice gap has perceptibly diminished over the last 10 years. These individual cases include Bhutan, Bolivia, Mongolia and Rwanda. In democracies, such social progress often goes hand in hand with functioning processes for the development of political consensus. Thus, among other factors, Mongolia owes its socioeconomic progress to a suspicious public, which has demanded that its political representatives extract a reasonably high national dividend from foreign mining explorations. Since 2006, Bolivian voters have regularly produced broad political majorities behind the Movimiento al Socialismo's neo-developmental economic policy focusing on high levels of public investment, an active social policy and countercyclical economic policy, while placing far less emphasis on market-based competition and private business activity. An inclusive social system can, in turn, contribute to the further development of a more inclusive democratic political system.

In countries with weaker or less active civil societies – typically autocracies, such as Rwanda, or young democracies, such as Bhutan – individual governments with social-policy agendas have taken the initiative and sought to strengthen their legitimacy by achieving palpable improvements in social conditions. The Rwandan government has expanded its provision of free education from the ages of nine to 12 years old and introduced a statutory health care insurance system. These measures are part of a comprehensive development program that is void of genuine democratization. Bhutan, too, has invested heavily in education, health care and infrastructure. The country has demonstrated considerable success in reducing poverty, but remains in the early stages with regard to the evolvement of a private sector.

These individual cases show that, under stable political conditions and with the prioritization of inclusive growth strategies, tangible social progress is possible in reasonable time periods. However, these promising examples do not add up to a significant, positive trend on the global level.

One opportunity for successful social policies in developing countries may rest in the realignment of the development-policy landscape in the 21st century. This could offer new alternatives to the predominantly Western donor countries and financial institutions. South-South cooperation has increased considerably in recent years. While development cooperation in the 1980s and 1990s was largely defined by the West, now a competition for successful development cooperation between the West, China and other countries is under way. This rivalry affords developing countries greater opportunity for choice in selecting their partners and greater freedom in the formulation of their own economic and social-policy priorities – a constellation that, of course, comes with increased national responsibility for that policy. It has yet to be seen whether non-Western partners will contribute over the long term to a socially balanced development.

Banks and capital markets more robust than before the crisis

The second gap, which is as dangerous as it is striking, is illustrated by the opposing trends of two BTI indicators that should be moving in harmony in a functioning market economy: the organization of the market and competition, and currency and price stability. Instead, BTI experts judge the fiscal situation and debt levels, in particular, to be significantly less stable in some regions than was the case a decade ago, while regarding banking systems and capital markets as being significantly more robust. This trend began shortly before the global economic and financial crisis, and has continued through the current BTI 2016.

In the wake of the 2007–2008 global financial crisis, banking systems in developing and transformation countries have been aligned more strongly toward international standards in areas such as capital resources, liquidity, independent oversight and transparency requirements. This has been a positive trend. Since the onset of the financial crisis, the corresponding BTI indicator measuring the solidity of banking systems and capital markets has improved more strongly than any other qualitatively compiled indicator of economic transformation, and even improved slightly more in the current period – rising by +0.51 points relative to the BTI 2008, and by +0.07 points relative to the BTI 2014.

In many emerging markets, the rapid stabilization of banking systems and capital markets following the outbreak of crisis in fact testified to the presence of functioning economic governance at the national level. The share of non-performing loans has decreased in most countries since 2009, and governments themselves have stepped in to help make credit available. Political experiences managing previous crises played a large part in the coordinated and relatively effective policy reaction. Despite all the disruptive consequences, this highlights a possible positive effect of economic crises: They expose regulatory failures of the past and can thereby initiate a learning process among policymakers that contributes to a more successful management of future crises.

These experiences were of great importance particularly in developing and emerging markets that were already strongly integrated into the global economy and were accordingly vulnerable to shocks. For example, this learning process had already taken place in Indonesia and South Korea during the 1997 Asian crisis. Brazil and Chile, too, are representative of a number of emerging markets that learned lessons regarding the coherency of fiscal and monetary policies and countercyclical economic policy from the late-1990s' crisis. Unsurprisingly, these states have been well-prepared for the new financial- and economic-policy challenge. Because of this previous experience, among other factors, countries in the South were more reluctant than those in Western Europe and North America to deregulate their financial markets even before the outbreak of the most recent crisis.

However, if we look at those countries where the proportion of non-performing loans has increased rather than decreased since 2009, we can identify regional nodes and causes of declining macroeconomic stability. This share has increased especially in some Southeastern European (Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Romania, Serbia, Slovenia) and Central and Eastern European (Czech Republic, Hungary) countries. Armenia, Bhutan and the United Arab Emirates round out the list.

The increase in public debt is an additional problem. In a number of countries, the public-debt ratio has doubled since 2008 (Croatia, Ghana, Honduras, Montenegro, Senegal, Serbia, Slovakia) or even tripled (Armenia, Bahrain, Romania, Ukraine). The leader here is also an Eastern European country; in Slovenia, debt has increased fourfold and now totals more than 80% of GDP.

Bank bailouts at the public expense in Eastern Europe

East-Central and Southeastern Europe thus offers a telling example of how the stabilization of banking systems and restoration of capital-market liquidity have contributed to economic instability. In Hungary, the persistently high level of government debt causes problems, while state intervention and investments in the banking sector have not yielded a medium-term return of relative stability. Recently, Széchenyi Bank and the Hungarian Trade Bank, both partially owned by the state, declared bankruptcy. Like many other Southeast and East-Central European states, Croatia lacks institutional guarantees; moreover, budgetary policy is subject to populist-driven uncertainties.

In addition to a relatively high share of non-performing loans, additional sources of instability have appeared in the post-Soviet states, including geopolitical conflicts, the low oil price and the economic sanctions against Russia, which is tightly linked with the countries of the former Commonwealth of Independent States (CIS) economic area. In this respect, the significance of the military conflicts involving Russia in Georgia in 2008, and particularly the destabilizing influence of the Ukraine crisis since 2014, can hardly be overestimated. For example, Armenia's economy has suffered for years from the decline in remittances from labor migrants in Russia, as well as from a large trade deficit and a crisis-prone tax structure. Kazakhstan, after initial problems during the financial crisis, was able to restore somewhat more stability, but cannot cope with the low oil price for long. The volume of foreign direct investment in Georgia is today considerably lower than before the August 2008 war with Russia.

In the years following the financial crisis, most developing and emerging markets were affected by declines in investment and declining demand for commodities. Revenue from the export of oil and other raw materials fell, and because economies in the OECD states slumped, remittances from labor migrants also declined.

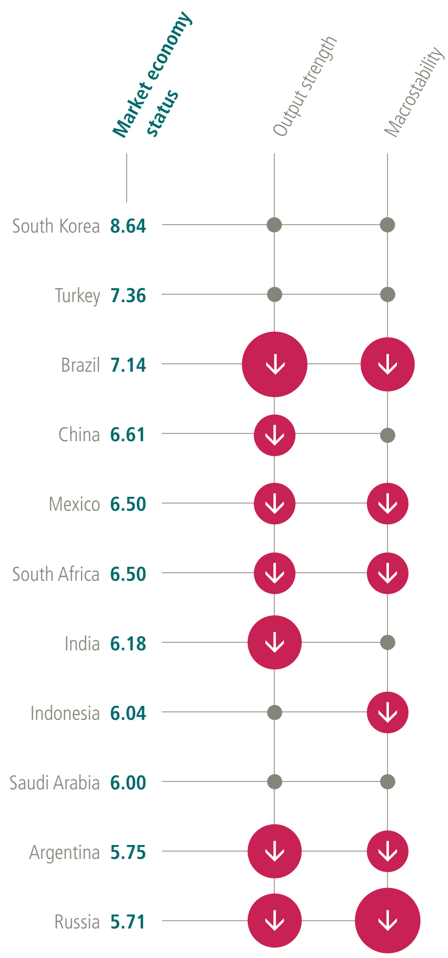
However, some countries have been able to defy this trend. The West African countries of Côte d'Ivoire (8 points / +5), Guinea (7 / +3), Liberia (7 / +2) and Togo (7 / +3) all have gained significantly in macrostability since 2008. In Bolivia, macroeconomic stability has improved by two points, to a total of nine, over the same time period. The economies of Asia and Oceania have remained at a constant and in many cases high level. South Korea lost a point following the financial crisis, but has remained at a constant eight points since 2010, and despite lower demand, managed to generate growth through one of the world's largest state investment packages measured as a share of GDP. Much the same is true of Malaysia, which has received a constant score of seven points since 2010.

The lesson that economic instability can quickly turn into political instability has roots even beyond the recent financial and economic crisis. The increasing interconnectedness of the globalized economy provides for a higher volume of trade and greater efficiency, but also increases the vulnerability to external shocks, while reducing individual states' abilities to take independent economic action. The decoupling of the globalized economy from national policies contributes to the impotence of national states with regard to increasing socioeconomic inequality, which is a major factor in the strengthening of social protest movements and populist political forces.

Market pressures limit political participation

On the other hand, global markets, and particularly financial markets, place enormous pressure to act on participatory systems' po-

Economic output decelerates in emerging economies



Score changes in two market-economic indicators for emerging G-20 economies, BTI 2012–BTI 2016 litical processes. Where the development of political consensus and decision-making processes are not restricted from the outset, as in authoritarian systems, these global market forces tend to limit the scope of distributive-policy decision-making. This ultimately amounts to a curtailment of democratic participation rights and a dominance by the executive. The increase in protests in many countries must be seen in this context.

The South African example of a coordinated and participatory policy process in response to the crisis represents an exception in this regard. As the realization dawned in the smallest of the BRICS states that even functioning banking regulations and low state debt offered no protection against the consequences of the global crisis, the government established a task force based on existing structures that had been set up in 1994 to ensure that social dialogue accompanies the development of economic policies. Consisting of government, labor, business and community representatives, the National Economic Development and Labor Council negotiated the framework for political measures and retained responsibility for their monitoring and implementation. This example shows that democratic processes and successful economic management do not necessarily preclude one another.

Most economies are suffering from more or less pronounced symptoms of a legitimacy deficit, with the number of protests in recent years going up around the world. Protesters' discontent has manifested itself not only in the desire for more democratic participation and a stronger rule of law; equally important are the economic-policy demands, such as the fundamental reform or even abolition of the international financial institutions, tax justice, labor-market improvements and the reduction of inequality.

In the major emerging markets that contribute the most to global economic growth, an additional legitimacy deficit is appearing. In many of these countries, the trust and credibility accorded to governments have been based on a high level of economic growth and rapid economic-transformation successes. The deterioration of this credibility was not primarily a result of the world economic crisis, which was generally well-managed. Rather, the lack of a return to the economic fast lane after the end of the crisis induced a strong decline in confidence. The "new normal" of average-to-good growth rates entails a contraction between continuing high expectations and the economic reality – a contradiction that can be observed quite well in the debate over China's growth prospects, where a failure to reach the 7% mark is already perceived by some observers as a threat to political stability.

Disillusionment in the BRICS countries

This "new normal" also explains why the BTI experts remain skeptical with regard to the assessment of economic performance in the emerging markets. Growth rates are no longer as high as in the years of plenty from 2004 to 2007. The indicator surveying the economic output of developing countries and emerging markets has fallen continually as a global average since the BTI 2008. Moreover, if the major growth engines of the South and East fall into greater difficulties, this would have far-reaching consequences for the industrialized and developing countries alike. In this regard, the negative signals from the emerging markets are worrisome. Since January 2011, the end of the BTI 2012's review period, all BRICS countries have declined in terms of economic performance: Brazil (–3 points), India and Russia (both –2 points) by the greatest amount, and China and South Africa (both –1) somewhat less. Argentina (–2) and Mexico (–1), too, have lost momentum. Of the 11 emerging markets in the G-20, only four – Indonesia, Saudi Arabia, South Korea and Turkey – have maintained the level reached in January 2011, and none has measurably improved since that point. The other 117 economies have experienced less severe declines in their economic output during this time period, but their weight in the global economy is also less.

In four of the five BRICS countries, currencies and prices have also grown more unstable. Brazil's central bank has had considerable difficulty in keeping inflation under control, particularly as the Rousseff government has been tasked with simultaneously stabilizing government finances, reducing the current account deficit, stopping the depreciation of the currency, and increasing regulated prices for electricity, gasoline and public transportation. India, too, had major problems with currency stability at least until 2013. Since that time, falling oil prices and the trust placed in the Modi government have led to a restoration of moderate inflation rates. The Russian economy is suffering not only from low oil prices, but also from Western sanctions. The reserves that provided liquidity and boosted the economy during the 2008 financial crisis and in the 2014–2015 period are expected to be exhausted in the course of the next three years. Finally, South Africa shows a volatile exchange rate due to a growing current account deficit, a low savings rate and dependence on short-term capital inflows.

Additional country-specific weaknesses and shortcomings further cloud the economic outlook for the emerging markets of the G-20 – high socioeconomic barriers in India, the lack of economic stability in Argentina, insufficient protections for private property in Russia, the inequality of opportunity in Saudi Arabia, and insufficiently sustainable policies in Indonesia. Nevertheless, these nations remain the drivers of economic transformation. Taken together, they sit significantly above the BTI average in all 14 indicators and, in many areas, continue to set the standard for other countries – for example, Mexico with regard to anti-inflation policy, South Korea with regard to education policy, or Turkey with regard to strengthening private enterprise. Their ability to retain the top places in future benchmarks will depend on whether they are able to recover the recently shaken confidence in the resilience of their economies and their social cohesion.

Economic transformation, BTI 2016

Developed market economies
Score 10 to 8

14

Taiwan	9.50
Czech Republic	9.36
Estonia	9.29
Lithuania	9.00
Poland	8.96
Singapore	8.96
Slovenia	8.82
Slovakia	8.64
South Korea	8.64
Uruguay	8.57
Latvia	8.50
Chile	8.39
Qatar	8.18
UA Emirates ▲	8.14

Functioning market economies
Score < 8 to 7

16

Romania	7.96
Costa Rica ▼	7.79
Hungary ▼	7.79
Bulgaria	7.68
Mauritius	7.57
Croatia	7.46
Botswana	7.43
Malaysia	7.43
Turkey	7.36
Kuwait	7.32
Peru	7.18
Brazil	7.14
Montenegro	7.11
Macedonia	7.07
Panama ▲	7.04
Serbia	7.00

Market economies with functional flaws
Score < 7 to 5

52

Colombia	6.64
China	6.61
El Salvador	6.50
Mexico	6.50
South Africa	6.50
Sri Lanka	6.50
Albania	6.46
Bosnia a. Herzegovina	6.46
Bahrain ▼	6.43
Namibia	6.36
Philippines	6.36
Oman	6.29
Thailand	6.29
India	6.18
Jordan	6.14
Jamaica	6.11
Indonesia	6.04
Kazakhstan	6.04
Kosovo	6.00
Paraguay	6.00
Saudi Arabia	6.00
Tunisia	6.00
Georgia	5.93
Mongolia	5.93
Vietnam	5.93
Armenia	5.89
Bolivia	5.86
Ghana	5.86
Rwanda	5.82
Dominican Republic	5.79
Lebanon	5.79
Moldova	5.79
Uganda	5.79
Argentina	5.75
Russia	5.71
Ecuador	5.64
Bhutan	5.54
Kyrgyzstan	5.46
Nicaragua	5.46
Algeria	5.43
Bangladesh	5.43
Azerbaijan	5.39
Kenya ▲	5.36
Morocco	5.36
Ukraine	5.36
Honduras	5.32
Zambia	5.14
Guatemala	5.11
Senegal ▲	5.07
Benin	5.00
Lesotho ▲	5.00
Tanzania ▲	5.00

Poorly functioning market economies
Score < 5 to 3

36

Egypt	4.86
Mozambique	4.86
Papua New Guinea ▼	4.82
Laos	4.75
Cameroon	4.71
Burkina Faso	4.68
Côte d'Ivoire	4.68
Belarus	4.61
Cuba	4.61
Malawi	4.61
Togo	4.61
Liberia	4.54
Madagascar	4.54
Cambodia	4.50
Mali	4.50
Mauritania	4.43
Guinea	4.36
Nigeria	4.36
Sierra Leone	4.32
Nepal	4.29
Burundi	4.11
Niger	4.11
Pakistan	4.11
Angola	4.07
Venezuela	4.07
Turkmenistan	3.93
Ethiopia	3.86
Uzbekistan	3.79
Rep. Congo	3.71
Tajikistan	3.64
Iraq	3.61
Chad	3.50
Zimbabwe	3.46
Haiti	3.18
Iran	3.00
Yemen ▲	3.00

Rudimentary market economies
Score < 3

11

Afghanistan	2.89
Libya ▼▼	2.89
DR Congo	2.79
Myanmar	2.75
Centr. African Rep. ▼	2.57
Sudan	2.39
South Sudan	2.36
Syria	1.89
North Korea	1.68
Eritrea	1.36
Somalia	1.25

▲ Movement to a higher category (each arrow denotes a single category)

▼ Movement to a lower category (each arrow denotes a single category)